

Letter is Final - Default 6-9-94

INTERNAL REVENUE SERVICE
District Director

Department of the Treasury

Date: FEB 10 1994

VIA CERTIFIED MAIL

Employer Identification Number:

Case Number:

Person To Contact:

Telephone Number:

In Reply Refer To:

Dear Applicant:

We have considered your application for exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code of 1986.

FACTS

The information submitted discloses that you were incorporated under the Nonprofit Public Benefit Corporation Law of the State of [REDACTED] on [REDACTED].

Article 3 of your articles of incorporation ("articles") states that your specific purpose is to "encourage and facilitate communications among user agencies, and between user agencies and the company."

The information submitted with your application for tax-exemption, Form 1023, discloses that your organization was set up by [REDACTED], a for-profit computer company that manufactures public safety software for public safety government agencies (e.g., police, sheriff, and fire departments). [REDACTED] is the "company" referred to in your articles as quoted above.

The purpose of your organization is to facilitate the exchange of information between the [REDACTED] software users and [REDACTED]. You achieve this purpose by holding an annual two and one-half day conference in [REDACTED]. Users attend seminars and discussion groups regarding the [REDACTED] software to help them better utilize it in their respective businesses. After the conference, a [REDACTED] employee (or employees) compiles the results of the conference, which include summaries of the small work group meetings and technological presentations, minutes of the general membership meeting, and a list of other agencies that operate systems similar to the participant, and sends them to the conference attendees. Assistance with the logistics of arranging the

conference is provided by [REDACTED] employees. Your organization is located at [REDACTED] in [REDACTED].

Although your organization's By-laws indicates that your organization is not a membership organization, item 10a of your Form 1023 indicates that voting membership in your organization is open to any agency with [REDACTED] public safety software installed or in progress of installation. Base membership dues is included in [REDACTED] project and maintenance contracts. In other words, purchase of the [REDACTED] project and maintenance contracts for the software makes the purchasing agency an automatic member. If user agencies do not choose to enter into a maintenance contract but would like to continue to participate in your organization, they may pay the dues directly to you or to [REDACTED], which will turn the money over to you.

Income is derived from membership dues and conference fees and substantially all of your expenses are incurred for the annual conference.

LAW

Section 501(c) of the Internal Revenue Code describes certain organizations exempt from income tax under section 501(a) and reads in part as follows:

"(3) Corporations, and any community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda or otherwise attempting, to influence legislation, (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c) of the Regulations defines the operational test. It states that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more such exempt purposes specified in section 501(c)(3). An organization

will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

According to Regs. section 1.501(c)(3)-1(d)(1)(ii), to further meet the operational test, an organization must be engaged in activities furthering "public" purposes, rather than private interests. It must not be operated for the benefit of designated individuals or the persons who created it.

ANALYSIS

Although your organization's activities benefit governmental agencies involved in public safety, this benefit is limited only to those agencies that have purchased and are using software manufactured by [REDACTED], a for-profit company. The benefit flowing to [REDACTED] is substantial. The conference, your primary activity, allows [REDACTED]'s clients to share information about their software thus facilitating more efficient and better use of their product. As such, your organization is operating for the private benefit of [REDACTED]. This is prohibited by Regs. section 1.501(c)(3)-1(c)(1)(ii) as stated above. This is further evidenced by the fact that your organization was created by [REDACTED] and the close operating relationship you share: purchase of a [REDACTED] maintenance contract makes the purchaser an automatic member in your organization; [REDACTED] provides substantial labor for the conference.

As you are not primarily engaged in an activity specified in section 501(c)(3) of the Code, you fail to meet the operational test. That is, you are not operated exclusively for one or more exempt purposes as required by Regulations section 1.501(c)(3)-1(c) but are operating for the private benefit of a for-profit company, [REDACTED]. Therefore, you are not entitled to exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code.

Consideration was also given to you for tax-exemption as an organization described in section 501(c)(6) of the Code. The facts remain the same.

LAW

Section 501(c) of the Internal Revenue Code describes certain organizations exempt from income tax under section 501(a) and reads in part, as follows:

"(6) Business leagues, chamber of commerce, real-estate boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual."

Section 1.501(c)(6)-1 of the Income Tax Regulations provides,

in part, as follows:

"A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons."

Revenue Ruling 74-147, 1974-1 C.B. 136 held that a nonprofit organization, whose members represent diversified businesses that own, rent, or lease digital computers produced by various manufacturers qualifies for exemption under section 501(c)(6) of the Code. In this case, the common business interest of the members is their common business problem concerning the use of digital computers in general. The organization provided a forum for the exchange of information thereby improving the efficiency of members' use of computers.

Revenue Ruling 83-164, 1983-2 C.B. 95 on the other hand held that an organization whose members represent diversified businesses that own, rent, or lease computers produced by a single computer manufacturer (referred to as the "M" corporation) does not qualify for exemption from Federal income tax as a business league under section 501(c)(6) of the Code. The organization holds conferences at which operational and technical problems relating to the M brand of computer are discussed. Representatives of M attend the conferences to disseminate current information relative to M's equipment. By directing its activities only to the users of M, it was ruled that the applicant organization is directing its activities towards the improvement of business conditions only in segments of the various lines of business to which its members belong. Because it limits its activities to the users of M computers, the organization helps to provide a competitive advantage to M and to its customers at the expense of M's competitors and their customers that may use other brands of computers.

In National Prime Users Group, Inc., v. U.S., (DC Md; 1987) 60 AFTR 2d 87-5564, the court found that a Corporation originally organized to facilitate communication among users of one manufacturer's computer equipment did not satisfy the "line of business" requirement and was not a tax exempt business league. The Articles of Incorporation and By-Laws as originally enacted conclusively established that the corporation was an organization serving only segments of one line of business, those using one manufacturer's product.

In National Muffler Dealers Association v. U.S., (1979) 43 AFTR 2d 779-828, the district court held that Midas muffler franchises do not constitute a "line of business" and that the petitioner was not a "business league" within the meaning of section 501(c)(6). The Court of Appeals affirmed, applying the maxim

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narrow to satisfy the "line of business" test of the Regulations. The Court held that the organization was not entitled to tax exemption as a "business league" within the meaning of section 501(c)(6) of the Code.

ANALYSIS AND CONCLUSION

In order to qualify for tax-exemption as a business league described in section 501(c)(6) of the Code, an organization's activities must be directed towards the improvement of business conditions in one or more lines of business as distinguished from the performance of particular services for individual persons.

The purpose of your organization is to act as a support group for users of ██████████ software, a particular brand of software manufactured by ██████████. You disseminate information about ██████████ software and related products to your members who are ██████████ users. As explained in Revenue Ruling 83-164 and in the National Prime Users Group court case, your organization does not serve to improve business conditions in one or more lines of business. You only serve to improve business conditions for those members of a line of business who use ██████████ products, as opposed to improving business conditions for all users of computer operating systems.

The above cited Revenue Rulings and court cases holds that exemption is not available to aid one group in competition against another within an industry. The "group" so aided should not be limited to the organization's membership. Because your organization serves only users of ██████████ manufactured products, ██████████ has an unfair competitive advantage over its competitors.

We have concluded that you do not qualify for exemption from Federal income tax as an organization described in section 501(c)(6) of the Internal Revenue Code.

Accordingly, you are required to file income tax returns, Form 1120, U.S. Corporate Income Tax Return, annually with your respective Service Center.

If you are in agreement with this proposed determination, we request that you sign and return the enclosed agreement Form 6018. Please note that the instructions for signing on the reverse side of this form.

If you are not in agreement with this proposed determination, we recommend that you request a hearing with our office of Regional Director of Appeals. Your request for a hearing should include a written appeal giving the facts, law, and any other information in support of your position as explained in the enclosed Publication 892. You will be contacted to arrange a date for a hearing. The hearing may be held at the Office of Regional Director of Appeals, or if you request, at a mutually convenient District Office. A self-addressed envelope is enclosed.

[REDACTED]

self-addressed envelope is enclosed.

If we do not hear from you within 30 days from the date of this letter, and you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies and will then become our final determination. Section 7428(b)(2) of the Internal Revenue Code provides, in part that, "a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the Court of Claims, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

Sincerely,

[REDACTED]

District Director

Enclosures:
Publication 892
Form 6018